

DOCKET FILE COPY ORIGINAL

**RECEIVED**

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

**APR 13 1993**

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

Simplification of the Depreciation )  
Prescription Process )

CC Docket No. 92-296

REPLY

James T. Hannon  
1020 19th Street, N.W.  
Suite 700  
Washington, D.C. 20036  
(303) 296-0239

Attorney for

U S WEST Communications. Inc.

TABLE OF CONTENTS

	<u>Page</u>
SUMMARY.....	ii
I. INTRODUCTION.....	1
II. WITH MINOR MODIFICATION, THE PRICE CAP CARRIER OPTION BEST SERVES THE PUBLIC INTEREST.....	5
III. THE "BASIC FACTORS RANGE" OPTION HAS WIDE SUPPORT AMONG COMMENTERS.....	9
IV. THE COMMISSION SHOULD TAKE STEPS IN THIS PROCEEDING TO RESOLVE THE RESERVE DEFICIENCY PROBLEM.....	11
V. THE COMMISSION SHOULD NOT CHANGE THE TREATMENT OF SALVAGE.....	12
VI. CONCLUSION.....	12

SUMMARY

Thirty-seven parties filed comments in response to the Commission's Notice of Proposed Rulemaking on Depreciation. LECs unanimously endorsed use of the Price Cap Carrier Option. Conversely, state PUCs unanimously opposed adoption of the Price Cap option and largely favored use of the Basic Factors Range. IXCs also opposed adoption of the Price Cap option. Opposition to the Price Cap option -- while not unexpected -- was based on two dissimilar concerns: (1) that Price Cap carriers would "game" the process to reduce sharing amounts; and (2) that adoption of the Price Cap option would result in the "loss" of much valuable depreciation information.

U S WEST believes that the Price Cap Carrier Option can be modified to address these concerns while still allowing LECs the flexibility to adjust depreciation rates in a timely manner to reflect competitive, technological, and regulatory changes. NYNEX and others offer a few simple guidelines which, if adopted, would ensure that LECs could not "game" the depreciation process. On the other hand, USTA suggests changes to the Price Cap option which would ensure that both the Commission and other interested parties have sufficient information to evaluate proposed depreciation rates. U S WEST urges the Commission to adopt a modified Price Cap option which incorporates the suggestions of NYNEX, USTA, and others. Such a plan would allow LECs the flexibility to adopt more realistic depreciation rates while safeguarding against potential abuse.

APR 13 1993

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

CC Docket No. 92-296

REPLY

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission" or "FCC") Notice of Proposed Rulemaking ("Notice" or

1) local exchange carriers ("LEC"); 2) state agencies (i.e., both regulatory agencies and consumer advocates) ("PUC"); 3) interexchange carriers ("IXC"); and 4) other interested parties. The LECs unanimously supported option D -- the Price Cap Carrier Option -- with the Basic Factors Range and the Depreciation Rate Range being second best alternatives. State PUCs unanimously opposed adoption of the Price Cap Carrier Option and favored use of the Basic Factors Range with some support for continuing existing depreciation practices. The IXCs -- AT&T and MCI -- strongly opposed allowing LECs to use the Price Cap Carrier Option, while AT&T argued that this option was the most appropriate for a carrier facing "pervasive competition" such as AT&T.<sup>3</sup> Option C - the Depreciation Schedule Option - garnered

---

<sup>2</sup>(...continued)

Pennsylvania Office of Consumer Advocate ("State Consumer Advocates"); The People of the State of California and the Public Utilities Commission of the State of California; Idaho Public Utilities Commission; Indiana Utility Regulatory Commission; Michigan Public Service Commission; Missouri Public Service Commission; National Association of Regulatory Utility Commissioners ("NARUC"); Nebraska Public Service Commission; New York State Department of Public Service; North Dakota Public Service Commission; Oklahoma Corporation Commission, Public Utility Division; Public Service Commission of Wisconsin; Public Utility Commission of Oregon; Public Utility Commission of Texas; South Dakota Public Utilities Commission; Tennessee Public Service Commission Staff; Utah Division of Public Utilities; Virginia State Corporation Commission Staff; Washington Utilities and Transportation Commission; California Cable Television Association ("CCTA"); Deloitte & Touche; and General Service

no support and was found to be unsuitable by every party commenting on it. Lastly, with the exception of some extreme variations of the Price Cap Carrier Option, no party provided any

---

<sup>3</sup>(...continued)

subject to a different price cap; faces significantly more competition; prices below its price cap; and has taken "write downs" on certain assets on its financial books. While U S WEST agrees that AT&T should be subject to liberalized depreciation rules, U S WEST cannot agree that price cap LECs should be subject to restrictive, out-dated depreciation practices.

The difference between AT&T and price cap LECs is one of degree. True, price cap LECs are subject to sharing and AT&T is not; but LECs would be happy to dispense with sharing if that is all that is necessary in order to be allowed to adopt more realistic depreciation practices. True, AT&T prices below its Price Cap Index ("PCI"), while most LECs have only recently begun to do so. (See U S WEST's 1993 Annual Access Tariff Filing in which switched and special access rates are significantly less than their respective PCIs -- the Switched Access PCI is 96.1021, while the API is 93.9634; the Special Access PCI is 99.1732, while the API is 97.0521. Furthermore, these PCIs do not reflect any upward adjustments due to OPEB or any 1993 represcriptions which may be ordered by the Commission.) However, it should be noted that LEC prices have continued to decline under price cap regulation. (U S WEST's prices declined approximately \$117 million and \$94 million in 1991 and 1992, respectively, and are expected to fall another \$47 million on July 1, 1993.)

It is also true that AT&T faces more direct competition than price cap LECs, but local access competition is exploding. (For example, Sprint Communications Company recently transferred all of its special access business in Denver from U S WEST to Teleport Denver.) It is also true that AT&T has taken "write downs" on its financial books and LECs have not -- but that is a financial decision. AT&T has not taken any "write downs" on its regulated books, nor have price cap LECs.

U S WEST can relate to AT&T's plight of being shackled with unrealistic depreciation practices while its competitors are not. However, AT&T performs an injustice when it asserts that it deserves regulatory relief from current depreciation practices but price cap LECs do not. It is unfortunate that AT&T has chosen to take the tact of trying to differentiate itself from price cap LECs for depreciation purposes rather than comparing itself to IXCs who are not subject to most of the Commission's

viable arguments that the Commission did not have authority to adopt rules implementing any of the proposed options.

All in all, the positions of the parties were fairly predictable.<sup>4</sup> The only surprise was the extent of state PUC participation, given the fact that this proceeding has no direct impact on intrastate depreciation rates.<sup>5</sup> Opposition to the Price Cap option -- while not unexpected -- was based on two dissimilar concerns: 1) Price Cap carriers would "game" the process to reduce sharing amounts; and 2) adoption of the Price

---

<sup>4</sup>CCTA devotes a significant portion of its pleading to addressing the issue of whether LEC depreciation expenses have exceeded new investment. Needless to say, CCTA infers that ratepayers will be harmed if depreciation expense exceeds new investment in any given year. See CCTA Table 1. U S WEST is replying to CCTA's comments because CCTA inaccurately references Mountain Bell and Northwestern Bell -- not because U S WEST believes that the level of LEC investment in any given year has or should have any relationship to the adequacy or inadequacy of depreciation rates.

In Table 1, CCTA compares net change in gross telephone plant in service ("TPIS") with depreciation expense for the period 1988-1990 for Mountain Bell and Northwestern Bell and other LECs. This is an inappropriate comparison and, contrary to CCTA's assertion, provides no information on LEC investment. The net change in TPIS is the difference between plant added and plant retired during a given period of time. To determine whether new investment was less than, equal to, or greater than depreciation expense for a given period, one should use either "plant added" from the MR2 report or "net construction expenditures" from the MR1 report, rather than net change in TPIS. If depreciation expense is compared to net construction expenditures for the period 1988-1990 for Mountain Bell and Northwestern Bell, it becomes clear that depreciation and new investment were basically equal during this period. Thus, CCTA's conclusion that depreciation exceeded new investment by a significant margin is clearly erroneous. As such, the Commission should give no weight to either CCTA's hypothesis or its conclusions in this proceeding.

<sup>5</sup>See Louisiana Public Service Com'n v. F.C.C., 476 U.S. 355 (1986).

Cap option would result in the "loss" of much valuable depreciation information.<sup>6</sup> U S WEST understands how these concerns could arise, given the limited description of the Price Cap Carrier Option in the Commission's Notice. However, U S WEST also believes that a Price Cap Carrier Option could be adopted which addresses these concerns while still giving LECs the flexibility to adjust depreciation rates in a timely manner to reflect changes in competitive, technological, and regulatory environments. USTA and others have already suggested modifications to the Price Cap option which ensure that LECs will not be able to use the depreciation process to reduce sharing amounts and that adequate data will be available to evaluate proposed LEC depreciation rates.

II. WITH MINOR MODIFICATION, THE PRICE CAP CARRIER OPTION BEST SERVES THE PUBLIC INTEREST

U S WEST and other price cap carriers argued that it makes no sense for the Commission to tightly circumscribe depreciation rates in light of the following facts: 1) depreciation is an endogenous cost under price caps;<sup>7</sup> 2) the existence of a growing

---

<sup>6</sup>Many state PUCs in U S WEST's service area voice this concern. As U S WEST said in its comments: "U S WEST has and will continue to work closely with state commissions to assist them in resolving depreciation and capital recovery issues, including providing any necessary data." U S WEST at 9 n.23.

<sup>7</sup>See, e.g., BellSouth at 16-19; Ameritech at 5; Pacific at 11-12.



reserve deficiency problem;<sup>8</sup> 3) rapidly changing technology and increasing competition;<sup>9</sup> and 4) the inherent slowness of a depreciation process which operates on three-year cycles.<sup>10</sup> Despite the logic of these arguments, they are insufficient by themselves to overcome some parties' distrust of the Price Cap option. U S WEST believes the Price Cap option can be modified to overcome this concern and to alleviate concerns with the adequacy of depreciation data under this option.

NYNEX and others offer a few simple guidelines which would ensure that LECs cannot "game" the depreciation process.<sup>11</sup> These suggestions include: 1) limiting depreciation changes to once a year;<sup>12</sup> 2) making all depreciation rate changes prospectively;<sup>13</sup> 3) requiring all proposed changes in depreciation rates be filed in the first quarter;<sup>14</sup> and 4)

---

<sup>8</sup>See, e.g., BellSouth at 16-17; Pacific at 2-3; U S WEST at 13.

<sup>9</sup>See, e.g., NYNEX at 2-3, 15-16; Ameritech at 3-4; Southwestern Bell at 5, 9-10.

<sup>10</sup>See, e.g., NYNEX at 4-5; Bell Atlantic at 4; Pacific at 2.

<sup>11</sup>Most concerns about "gaming" the depreciation process center around the changing method of depreciation.

limiting the amount of yearly depreciation rate changes.<sup>15</sup>

Adoption of these additional guidelines would ensure that LECs could not use the depreciation process to arbitrarily reduce sharing amounts.<sup>16</sup> In making its decision on depreciation methodologies, the Commission should not overlook the fact that numerous safeguards are already in place which make manipulation of depreciation expenses very unlikely. These safeguards include: public books and records including SEC filing requirements; the use of independent auditors; adherence to FCC accounting rules in Part 32; regulatory agency audits (e.g., NECA audits, etc.); and the oversight of the financial community (e.g., analysts' reports, etc.).

parties have sufficient information to evaluate proposed depreciation rates.

Under USTA's proposal, carriers "would file the major data elements to calculate the depreciation rates - reserves, life and salvage estimates, current and proposed depreciation rates, and accrual changes, with a letter of explanation."<sup>17</sup> Carriers would continue to calculate depreciation rates using a remaining life methodology, as they do today. The Commission would then put a carrier's depreciation rates and supporting material out for comment. Upon completion of the notice and comment proceeding, the Commission would prescribe rates.<sup>18</sup> Also, USTA's proposal should alleviate any concerns that the Commission would be abdicating its statutory duties to prescribe depreciation rates with the adoption of the Price Cap option.

U S WEST urges the Commission to adopt a modified Price Cap option which incorporates the above revisions. By doing so, the Commission would address the valid concerns raised by commenters while still allowing carriers the flexibility to change depreciation rates to reflect a rapidly changing operating environment. Additionally, U S WEST believes the adoption of this option would obviate the need for a separate reserve deficiency amortization ("RDA").

---

<sup>17</sup>USTA at 10.

<sup>18</sup>Id.

### III. THE "BASIC FACTORS RANGE" OPTION HAS WIDE SUPPORT AMONG COMMENTERS

The Basic Factors Range (or "BFR") option found wide support among state regulators.<sup>19</sup> LECs, while voicing strong support for the Price Cap option, found an appropriately-fashioned Basic Factors Range option to be a viable "second best" alternative.<sup>20</sup> The big difference in views between LECs and state regulators on this option had to do with its applicability.<sup>21</sup> Regulators, while supporting the BFR option, also urged that it be limited to small accounts. Conversely, LECs argued that this option should be applied to all accounts. U S WEST continues to support the application of the BFR option to all accounts. Applying this option solely to small accounts would in effect be a preservation of the status quo. The status quo is the problem. While the Commission has styled its Notice

---

<sup>19</sup>See, e.g., Idaho Public Utilities Commission at 2; Nebraska Public Service Commission at 2; Staff of the New Jersey Board of Regulatory Commissioners at 3.

<sup>20</sup>See, e.g., U S WEST at 9; Bell Atlantic at 10-11; BellSouth at 34-36.

<sup>21</sup>State regulators also appear to differ with LECs on the continued use of Equal Life Groups ("ELG") under the BFR option. See, e.g., Colorado Public Utilities Commission at 18-19; Idaho Public Utilities Commission at 4; Utah Division of Public Utilities at 3. In its Notice, the Commission requested comment on the continued use of ELG given the fact that basic factor ranges would be calculated using industry-wide data. See Notice at ¶ 25. If the Commission adopts the BFR option, it should continue to allow LECs to use ELG. ELG is more accurate than vintage grouping ("VG") and its use results in different depreciation rates than would be obtained from VG for a given value within a basic factor range. U S WEST believes that use of ELG results in more realistic depreciation rates.

as a "simplification of the depreciation prescription process," it would be regretful if the only outcome of this proceeding is "simplification," with no reform of the depreciation process.<sup>22</sup>

Thus, while application of the BFR option to a limited number of accounts would be an improvement over current

practices, it would do little to bring IEC depreciation rates

IV. THE COMMISSION SHOULD TAKE STEPS IN THIS PROCEEDING TO  
RESOLVE THE RESERVE DEFICIENCY PROBLEM

Numerous LECs noted that they faced reserve deficiencies and that these deficiencies are growing.<sup>24</sup> These reserve deficiencies are the product of overly-long service lives that were prescribed for LECs for depreciation purposes. Not only must the Commission realign depreciation rates on a going-forward basis, but it must also address the reserve deficiency issue.<sup>25</sup> Expeditious action on this problem will serve the public interest and pave the way for even greater competition.<sup>26</sup> As U S WEST observed in its comments, a separate RDA probably would be unnecessary if the Commission selected the Price Cap option for establishing depreciation rates. If the Commission does not select the Price Cap option, it should institute a proceeding to address the industry-wide problem of reserve deficiencies at the earliest possible date.

---

<sup>24</sup>See, e.g., NYNEX at 6; Bell Atlantic at 4-5; U S WEST at 13.

<sup>25</sup>The Commission staff is well aware of both the existence of LEC reserve deficiencies and the fact that these deficiencies are growing. LECs are required to file theoretical studies with the Commission on a regular basis as required by the FCC Depreciation Study Guide.

<sup>26</sup>Today's reserve deficiencies are the result of past regulatory decisions on depreciation. Ratepayers in previous periods benefitted from these decisions. It would be patently unfair and an abuse of discretion to deprive LECs of an opportunity to recover these reserve deficiencies.

V. THE COMMISSION SHOULD NOT CHANGE THE TREATMENT OF SALVAGE

Salvage and cost of removal are currently included in LEC depreciation calculations. GSA and a few other parties favor removing salvage (and the cost of removal) from the depreciation process.<sup>27</sup> These parties advocate treating salvage and cost of removal as current expenses when they occur.<sup>28</sup> U S WEST

13

urges the Commission to adopt a modified version of its Price Cap option for establishing carrier depreciation rates.

Respectfully submitted,

U S WEST Communications, Inc.

By:

James T. Hannon

James T. Hannon  
1020 19th Street, N.W.  
Suite 700  
Washington, D.C. 20036  
(303) 296-0239

Its Attorney

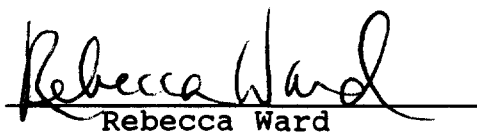
Of Counsel,  
Laurie J. Bennett

April 13, 1993



CERTIFICATE OF SERVICE

I, Rebecca Ward, do hereby certify on this 13th day of April, 1993, that I have caused a copy of the foregoing **Reply** to be served via first class United States mail, postage prepaid, upon the persons named on the attached service list.

  
Rebecca Ward

\* via hand delivered

Cheryl A. Tritt, Chief\*  
Common Carrier Bureau  
Federal Communication  
Commission  
1919 M Street, N.W.  
Room 500  
Washington, D.C. 20554

Floyd S. Keene  
Barbara J. Kern  
Ameritech Operating  
Companies  
2000 West Ameritech Center  
Drive  
Room 4H88  
Hoffman Estates, IL 60196

Kenneth P. Moran, Chief\*  
Accounting & Audits Division  
Federal Communications  
Commission  
2000 L Street, N.W.  
Room 812  
Washington, D.C. 20036

Francine J. Berry  
Robert J. McKee  
Peter H. Jacoby  
American Telephone and  
Telegraph Company  
295 North Maple Avenue  
Room 3244J1  
Basking Ridge, NJ 07920

Fatima K. Franklin, Chief\*  
Depreciation Rates Branch  
Accounting & Audits Division  
Federal Communications  
Commission  
2000 L Street, N.W.  
Room 257  
Washington, D.C. 20036

William B. Barfield  
M. Robert Sutherland  
BellSouth Telecommunications  
Inc.  
1155 Peachtree Street, N.E.  
Suite 1800  
Atlanta, GA 30367

Sonja J. Rifken\*  
Accounting & Audits Division  
Federal Communications  
Commission  
2000 L Street, N.W.  
Room 257  
Washington, D.C. 20036

Christopher W. Savage  
Edward D. Young  
Bell Atlantic  
1710 H Street, N.W.  
Washington, D.C. 20006

International Transcription  
Services\*  
Federal Communications  
Commission  
1919 M Street, N.W.  
Room 246  
Washington, D.C. 20554

Peter Arth, Jr.  
Edward W. O'Neill  
Ellen S. LeVine  
California PUC  
505 Van Ness Avenue  
San Francisco, CA 94102

Frank W. Lloyd  
Mintz. Levin. Cohn. Ferris

Allis B. Latimer  
Vincent L. Crivello

Elizabeth Dickerson  
MCI Telecommunications  
Corporation  
1801 Pennsylvania Ave., N.W.  
Washington, D.C. 20006

Susan E. Wefald  
Leo M. Reinbold  
Bruce Hagen  
N.D. Public Service Commission  
State Capitol  
Bismarck, North Dakota 58505

Mary McDermott  
Campbell L. Ayling  
NYNEX Telephone Companies  
120 Bloomingdale Road  
White Plains, NY 10605

Frank E. Landis  
Nebraska Public Service  
Commission  
300 The Atrium  
Lincoln, Nebraska 68508

Paul Rodgers  
Charles D. Gray  
James Bradford Ramsay  
NARUC  
1102 ICC Building  
Post Office Box 684  
Washington, D.C. 20044

Ron Eachus  
Joan H. Smith  
Roger Hamilton  
Oregon Public Utility  
Commission  
550 Capitol St. NE  
Salem, OR 97310-1380

Michael P. Gallagher  
State of New Jersey  
Board of Regulatory  
Commissioners  
CN 350  
Trenton, N.J. 08623-0380

Maribeth D. Snapp  
Oklahoma Corporation  
Commission  
Public Utility Division  
400 Jim Thorpe Office Building  
Oklahoma City, OK 73105

William J. Cowan  
New York State Department  
of Public Service  
Three Empire State Plaza  
Albany, NY 12223

Michael McRae  
District of Columbia  
Office of People's Counsel  
1133 15th St., NW, Suite 500  
Washington, D.C. 20005

Philip F. McClelland  
Laura Jan Goldberg  
Pennsylvania Office of  
Consumer Advocate  
Office of Attorney General  
1425 Strawberry Square  
Harrisburg, PA 17120

Rowland L. Curry  
Telephone Utility Analysis  
Division  
Public Utility Commission of  
Texas  
7800 Shoal Creek Boulevard  
Austin, Texas 78757

Tim Seat  
Indiana Office of Utility  
Consumer  
100 N. Senate Avenue  
Room N 501  
Indianapolis, IN 46204

Thomas F. Peel  
Utah Division of Public  
Utilities  
160 East 300 South  
P.O. Box 45807  
Salt Lake City, UT 84145-0807

Charles Beck  
Earl Poucher  
Florida Office of  
Public Counsel  
812 Claude Pepper Building  
111 West Mochian St.  
Tallahassee, FL 32399

Martin T. McCue  
United States Telephone Assn.  
900 19th St., N.W.  
Suite 800  
Washington, D.C. 20006-2105

James E. Taylor  
Richard C. Hartgrove  
Bruce E. Beard  
Southwestern Bell  
One Bell Ctr., Suite 3520  
St. Louis, Missouri 63101

Jay C. Keithley  
United Telephone - Southeast  
1850 M St., N.W.  
Suite 1100  
Washington, D.C. 20036

Linda D. Hershman  
Southern New England Telephone  
227 Church Street  
New Haven, CT 06510

W. Richard Morris  
United Telephone - Southeast  
P.O. Box 11315  
Kansas City, MO 64112

Edward C. Addison  
William Irby  
Virginia State Corporation  
Commission Staff  
P.O. Box 1197  
Richmond, Virginia 23209

Sharon L. Nelson  
Richard D. Casad  
WA Utilities and  
Transportation Commission  
P.O. Box 47250  
Olympia, WA 98504-7250

Scot Cullen  
Public Service Commission  
of Wisconsin  
4802 Sheboygan Avenue  
P.O. Box 7854  
Madison, Wisconsin 53707-7854

Austin J. Lyons  
Telecommunications Division  
Tennessee Public Service  
Commission  
460 James Robertson Parkway  
Nashville, TN 37243-0505

Deloitte & Touche  
Accounting Dept.  
1900 M St., N.W.  
Washington, D.C. 20036

Laska Schoenfelder  
Kenneth Stofferahn  
James A. Burg  
SD Public Utilities Commission  
State Capitol Building  
Pierre, SD 57501